Report

of the

Examination of

Kenosha County Mutual Insurance Company

Bristol, Wisconsin

As of December 31, 2004

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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May 27, 2005

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2004, of the affairs and financial condition of:

KENOSHA COUNTY MUTUAL INSURANCE COMPANY
Bristol, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The previous examination of Kenosha County Mutual Insurance Company (the company) was made in 1999 as of December 31, 1998. The current examination covered the intervening time period ending December 31, 2004, and included a review of such subsequent transactions deemed essential to complete this examination.

The “Summary of Examination Results” contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was organized as a town mutual insurance company on February 26, 1860, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Bristol Mutual Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there was one amendment to the articles of incorporation and no amendments to the bylaws. The company changed the date of their annual meeting from the third Tuesday of January to the second Tuesday of February. This change was approved by this office in February 1999.

The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance. The company is currently licensed to write business in the following counties: Kenosha, Racine, and Walworth.

A review was made of the policy and application forms currently used by the company. The company issues approved policies with or without endorsements for a term of one year with premiums payable on the advance premium basis. The company does not charge any other fees to policyholders.

Business of the company is acquired through two agents, none of whom are directors of the company. Agents are presently compensated for their services as follows:

Type of Policy	**Compensation**
Fire/Extended Coverage (new)	10.00%
Fire/Extended Coverage (renewal)	10.00
Liability (new)	10.00
Liability (renewal)	10.00

Agents do not have authority to adjust losses. Losses are adjusted by the adjusting committee described later in this report. Adjusters receive $40.00 for the first three hours or less and $20.00 each additional hour.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are not held in accordance with its articles of incorporation, see comments in the summary of current examination results.

Board of Directors

The board of directors consists of nine members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Myron Daniels	Dairy Farmer	Brighton, Wisconsin	2008
Gloria Bailey	Retired	Bristol, Wisconsin	2007
Leroy Reiter	Dairy Farmer	Brighton, Wisconsin	2006
Janet Elfering	Office Manager	Bristol, Wisconsin	2007
Hector Velasquez	Self-employed	Salem, Wisconsin	2006
Dennis Sheen	Retired	Salem, Wisconsin	2007
Noel Elfering	School Bus Driver	Bristol, Wisconsin	2008
Glen Rasmussen	Retired	Somers, Wisconsin	2008

Charles Tunkieicz passed away in May 2005 and the company had not filled his position at the time of examination.

Members of the board currently receive $50.00 for each meeting attended and $0.36 per mile for travel expenses.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified. Officers serving at the present time are as follows:

Name	Office	2004 Salary
Myron Daniels	President	$ 6,000
Gloria Bailey	Vice President	750
Leroy Reiter	Treasurer	12,650
Janet Elfering	Secretary	17,050

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Adjusting Committee
Leroy Reiter, Chair
All directors are members of this committee

Financial Committee
Leroy Reiter, Chair
All directors are members of this committee

Growth of Company

The growth of the company since the previous examination as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
2004	$125,673	530	$ (8,154)	$3,388,597	$3,216,243
2003	138,693	525	99,215	3,158,425	2,996,896
2002	107,289	526	48,001	3,001,552	2,818,384
2001	135,265	522	76,739	3,073,885	2,943,227
2000	144,455	538	11,281	2,984,467	2,863,777
1999	133,562	567	111,106	2,925,569	2,782,000
1998	144,411	605	84,413	3,025,754	2,734,567

The ratios of gross and net premiums written to surplus as regards policyholders since the previous examination were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios Gross	Net
2004	$262,796	$116,170	$3,216,243	8.2%	3.6%
2003	256,416	138,365	2,996,896	8.6	4.6
2002	249,725	114,057	2,818,384	8.9	4.0
2001	234,318	133,220	2,943,227	8.0	4.5
2000	235,853	137,898	2,863,777	8.2	4.8
1999	248,781	147,093	2,782,000	8.9	5.3
1998	222,436	148,000	2,734,567	8.1	5.4

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Com-posite Ratio
2004	$116,697	$98,927	$125,673	93%	85%	178%
2003	44,925	92,265	138,693	32	67	99
2002	120,856	80,760	107,289	113	71	183
2001	152,896	78,831	135,265	113	59	172
2000	244,361	77,236	144,455	169	56	225
1999	132,360	72,475	133,562	99	49	148
1998	168,033	65,440	144,411	116	44	161

The company had a net loss in 2004 for the first time in over 25 years due to a decrease in investment income and a high composite ratio. Growth in investment income was dampened by lower available reinvestment rates on the company’s fixed maturities. However, policyholders' surplus increased 7% in 2004, the highest amount reported in 10 years, mainly due to unrealized capital gain on the value of the company's Wisconsin Reinsurance Corporation stock. Policies in force have decreased by 12% from 1998. Gross premium written increased 18%, and net premium written decreased 22%, respectively, since 1998. The portion of written premiums ceded to purchase reinsurance has increased from 34% in 1998 to 56% in 2004. The increase in gross written premium was mainly due to the fact that the insured property has increased in value, not due to rate increases.

The company's expense ratios of 85% in 2004 and 67% in 2003 are considered to be high when compared to other town mutual insurers whose expense ratio averages in the low 40% range. The high expense ratio is partially due to the fact that the company started buying an additional layer of reinsurance and also due to the company investing in a new computer and accounting software. Although 2004 was a good year with a relatively low amount of losses, the company had a high composite ratio (2004 composite ratio was 178%; average composite ratio for 6 years was 167%). The company offers a premium discount of 25% for all property coverage which contributes to the overall high composite ratio. Reinsurance premiums for property coverage are based on the undiscounted premium, which contributes to the high portion of premiums ceded. Considering the highly competitive environment of the surrounding territories, the company considers the premium discount to be crucial in attracting and retaining customers. Currently the company is weighing a few options including expanding its operations into new lines of business and/or new territories.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2005
Termination provisions:	Either party may terminate the contract as of any subsequent January 1 by giving to the other party at least 90 days advance notice in writing.

The coverages provided under this treaty are summarized as follows:

1.	Type of contract:	Class A – Casualty Quota Share Reinsurance
	Lines reinsured:	All Casualty business
	Company's retention:	The company has no retention on casualty losses
	Coverage:	100% of each and every loss, including loss adjustment expense, occurring on the business covered, subject to the following maximum policy limits: • $1,000,000 per occurrence, single limit or combined for bodily injury and property damage liability • 1,000,000 split limits, in any combination of bodily injury and property damage liability • $5,000 for medical payments, per person; $25,000 per accident
	Reinsurance premium:	100% of gross premium written
	Ceding commission:	15% of the premium paid to the reinsurer
2.	Type of contract:	Class B – First Surplus Reinsurance
	Lines reinsured:	All property business
	Company's retention:	Retained pro rata portion of each risk
	Coverage:	When the company net retention is $300,000 or more in respect to a risk, the company may cede on a pro rata basis, and the reinsurer shall accept up to $800,000 When the company's net retention is $300,000 or less in respect to a risk, the company may cede on a pro rata basis, and the reinsurer shall accept up to 50% of such risk

Reinsurance premium:	The pro rata portion of all premiums corresponding to the amount of each risk ceded
Ceding commission:	15% of the premium paid to the reinsurer

Contingent commission:
15% of the net profit accruing to the reinsurer during each accounting period. Net profit is defined as follows:

- Premiums earned for the accounting period; less
- Ceding commission on premiums earned for the accounting period; less
- Expenses incurred by the reinsurer calculated at 10% of premiums earned for the period; less
- Losses and LAE incurred for the period; less
- The reinsurer's net loss from the immediately preceding accounting period

3. Type of contract: Class C-1 – Excess of Loss First Layer

Lines reinsured:	All property business
Company's retention:	$50,000 per loss
Coverage:	100% of any loss, including loss adjustment expense, in excess of $50,000 in respect to each and every risk resulting from one loss occurrence, with a $100,000 limit
Reinsurance premium:	Net premium written times (sum of the prior four years' losses incurred divided by the total of the net premiums written for the same period times 100/80hts)

Minimum rate:	7.00%
Maximum rate:	20.00%
Current rate:	12.09%

Deposit premium:	$32,401
Minimum premium:	$24,000

Ceding commission: None

4. Type of contract: Class C-2 – Excess of Loss Second Layer

Lines reinsured:	All property business
Company's retention:	$150,000 per loss
Coverage:	100% of any loss, including loss adjustment expense, in excess of $150,000 in respect to each and every risk resulting from one loss occurrence, with a $150,000 limit
Reinsurance premium:	5% of current net premium written subject to a deposit premium of $13,400 Current minimum premium is $9,400
Ceding commission:	None

5.	Type of contract:	Class D/E – Aggregate Stop Loss-First Layer
	Lines reinsured:	All property and non-property business
	Company's retention:	Losses, including loss adjusting expenses, up to an amount equal to 100% of the company’s net written premium, subject to minimum retention of $185,000
	Coverage:	100% of losses in excess of the company’s retention
	Reinsurance premium:	Net premium written times (sum of the prior eight years’ losses incurred by the reinsurer divided by the total of the net premium written for that same period times 100/80ths)

Minimum rate:	7.00%
Maximum rate:	25.00%
Current rate:	7.00%

Deposit premium:	$18,760
Minimum premium:	$14,000

	Ceding commission:	None

III. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2004, annual statement. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Kenosha County Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2004

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash deposited in checking account	$ 26,445	$	$	$ 26,445
Cash deposited at interest	626,597			626,597
Bonds	1,308,200			1,308,200
Stocks and mutual fund investments	1,401,086			1,401,086
Premiums, agents' balances and installments:				
In course of collection	6,236			6,236
Investment income accrued		16,203		16,203
Electronic data processing equipment	1,538			1,538
Other expense-related assets:				
Reinsurance contingent commission receivable	2,292			2,292
Other nonadmitted assets:				
Software	16,999		16,999	
Totals	$3,389,393	$16,203	$16,999	$3,388,597

Liabilities and Surplus

Net unpaid losses	$ 48,281
Unpaid loss adjustment expenses	405
Commissions payable	2,139
Fire department dues payable	77
Unearned premiums	92,947
Reinsurance payable	10,562
Amounts withheld for the account of others	256
Payroll taxes payable (employer’s portion)	431
Other liabilities:	
Expense-related:	
Accounts payable	3,773
Nonexpense-related:	
Premiums received in advance	13,483
Total Liabilities	172,354
Policyholders' surplus	3,216,243
Total Liabilities and Surplus	$3,388,597

Kenosha County Mutual Insurance Company
Statement of Operations
For the Year 2004

Net premiums and assessments earned		$125,673
Deduct:		
Net losses incurred	$ 97,507	
Net loss adjustment expenses incurred	19,190	
Other underwriting expenses incurred	98,927	
Total losses and expenses incurred		215,624
Net underwriting gain (loss)		(89,951)
Net investment income:		
Net investment income earned	95,160	
Net realized capital gains	(13,363)	
Total investment gain (loss)		81,797
Net income (loss) before federal income taxes		(8,154)
Federal income taxes incurred		0
Net Income (Loss)		$ (8,154)

Kenosha County Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Six-Year Period Ending December 31, 2004

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	2004	2003	2002	2001	2000	1999
Surplus, beginning of year	$2,996,896	$2,818,384	$2,943,227	$2,863,777	$2,782,000	$2,734,567
Net income	(8,154)	99,215	48,001	76,739	11,281	111,106
Net unrealized capital gains or (losses)	221,688	76,249	(146,984)	2,711	70,496	(63,673)
Change in nonadmitted assets	5,813	3,048				
Surplus, end of year	$3,216,243	$2,996,896	$2,818,384	$2,943,227	$2,863,777	$2,782,000

Reconciliation of Policyholders' Surplus

The examination resulted in no adjustments to policyholders’ surplus. The amount reported by the company as of December 31, 2004, is accepted.

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Corporate Records—It is recommended that the company document the number of policyholders present at each annual meeting so that it may be determined that a quorum was present.

   Action—Compliance.

2. Corporate Records—It is again recommended that the company report biographical data relating to officers and directors in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

   Action—Compliance.

3. Reinsurance—It is suggested that the company annually review the benefits and risks associated with not utilizing its Class B layer of reinsurance.

   Action—Compliance.

4. Underwriting—It is recommended that the company establish a formal inspection procedure for new and renewal business, whereby a sampling of new applications and of renewal business is inspected by committee members or a professional inspector independent of the risk under consideration.

   Action—Compliance.

5. Accounts and Records—It is recommended that the company maintain a proper general journal pursuant to s. Ins 13.05 (3) (d), Wis. Adm. Code.

   Action—Compliance.

6. Accounts and Records—It is recommended that the company maintain a proper general ledger pursuant to s. Ins 13.05 (3) (e), Wis. Adm. Code.

   Action—Compliance.

7. Accounts and Records—It is recommended that the company receive and retain all cancelled checks from its checking account as required by s. Ins 6.80 (4) (c), Wis. Adm. Code.

   Action—Compliance.

8. Accounts and Records—It is again recommended that the company mark its invoices and voucher/check orders as paid upon disbursement in order to avoid duplicate payments.

   Action—Compliance.

9. Accounts and Records—It is recommended that the company file Unclaimed Property Reports as required by s. 177, Wis. Stat., and maintain copies of these filings.

   Action—Compliance.

10. Disaster Recovery Plan—It is recommended that the company develop a disaster recovery plan.

    Action—Compliance.

11. Invested Assets—It is recommended that the company maintain completed copies of all corporate agreements.

    Action—Compliance.

12. Invested Assets—It is recommended that the company have more specific written guidelines concerning invested assets.

    Action—Compliance.

13. Cash and Invested Cash—It is recommended that the company establish written cash procedures that include when money should be deposited into the maximizer savings account and when money should be transferred to the checking account.

    Action—Compliance.

14. Cash and Invested Cash—It is recommended that the company establish a policy regarding the number and authority of the authorized signators and keep such signators updated on its accounts.

    Action—Compliance.

15. Book Value of Bonds—It is recommended that the company promptly redeem all due and called bonds.

    Action—Compliance.

16. Stocks and Mutual Fund Investments—It is recommended that the company properly complete Schedule D, Section 1 – Part 2, of the annual statement including all required information.

    Action—Compliance.

17. Agents' Balances or Uncollected Premiums—It is recommended that the company properly nonadmit premium receivables that are in excess of 90 days past due.

    Action—Compliance.

18. Net Unpaid Losses—It is recommended that the company comply with s. Ins 13.05 (3) (f) and (4) (e), Wis. Adm. Code.

    Action—Partial compliance, see comments in the summary of current examination results.

19. <u>Net Unpaid Losses</u>—It is recommended that the company, in order to avoid the unfair claims settlement practice described in s. Ins 6.11 (3) (a) (1), Wis. Adm. Code, document all communications with insureds and claimants.

    Action—Partial compliance, see comments in the summary of current examination results.

20. <u>Unpaid Loss Adjustment Expenses</u>—It is recommended that the company maintain a record of loss adjusting expenses and establish a method of determining unpaid loss adjustment expenses.

    Action—Partial compliance, see comments in the summary of current examination results.

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and committees thereof were reviewed for the period under examination and also for the subsequent period. It was noted that a quorum was not present at one of the annual meetings. It is recommended that the company adhere to its articles of incorporation as they relate to the minimum number of members, or quorum, required to be present at the annual meeting before it can validly proceed to transact business.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being noted.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has not complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity bond	$ 250,000
Worker's compensation:	
Employee injury	Statutory
Employer's liability:	
Each accident	100,000
Each employee	100,000
Policy limit	500,000
Business owners	
Liability	100,000
Medical expense	1,000 per person 25,000 each accident
Office equipment and supplies	7,000
Professional liability (A)	1,000,000 each claim and in aggregate
Directors and officers liability (B)	1,000,000 each claim and in aggregate
Total for (A)and (B) noted above	1,000,000 aggregate for policy period
Agents errors and omissions	1,000,000 each claim and in aggregate

The fidelity bond coverage currently purchased by the company is sufficient to meet the requirements of s. Ins 13.05 (6), Wis. Adm. Code. However, two officers of the company who have direct access to the company's assets are not covered by the fidelity bond. One of the officers has check writing and bank deposit authority, and both officers have access to the company's investment accounts. It is recommended that the company obtain proper fidelity bond coverage for all officers, directors, and employees having direct access to the company's assets in accordance with s. Ins 13.05 (6), Wis. Adm. Code.

Underwriting

The company does not have a written underwriting guide for its property business. It appears that the company has informal underwriting guidelines which are based on business experience and the personal knowledge of the company's directors and agents. However, in the event of a change in business or personnel, this knowledge and expertise might be lost, which might lead to unfair discrimination by the company among policyholders in the process of underwriting a policy. It is recommended that the company define and document the underwriting guidelines it follows in its business practice in order to avoid unfair discrimination among policyholders described in s. 628.34 (3) (a), Wis. Stat.

The company has a formal inspection procedure for both new and renewal business. All new applications and renewal business are inspected by the company's agents. In the event that the agents have questions regarding the coverage or conditions of the property, the agents are assisted by the committee members who are independent of the risk under consideration. Starting in 2005, photographs will be required for some of the insured property. The requirements are not defined and the decision to take photographs is left to the company's agent's judgment. The company is currently working on developing a set of criteria to determine whether or not photographs will be required for the insured property. It is suggested that the company finalize its criteria for requiring photographs of insured property.

During review of the ten largest risks, it was noted that the company incorrectly reported the amount of the largest fire risk in the general interrogatories on the annual statement. The company reported the amount of the largest risk at $1,036,400 with a net retention of $300,000 based on a single policy risk. It was discovered that the company may write several policies covering a single location, at the request of the policyholder. The largest risk in one location based on such combined policies was $1,741,250 with the company's retention being $436,313. It was also discovered that the company incorrectly calculated net retention related to the largest risk reported in the general interrogatories. Instead of calculating net retention based on a ceding percentage for that policy determined by the board of directors, the company reported net retention of 300,000. (The board of directors decided to retain a different amount of risk on this policy than the amount agreed upon in the reinsurance contract.) The company underreported net retention for this particular risk by $10,920. It is recommended that the company properly complete general interrogatories on all future annual statements by reporting the amount of the largest risk and the company's net retention in regard to this risk in accordance with the Town Mutual Annual Statement Instructions.

Claims Adjusting

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses. At each annual meeting, the members of the board of directors appoint a chair of the adjusting committee with a stipulation that all other members of the board will assist the chair. All claims are reviewed and approved by the members of the board of directors at the regular meetings.

Accounts and Records

The examiners' review of the company's records indicated that, other than the fidelity bond issue described above, the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2004.

The company is not audited annually by an outside public accounting firm, as it is exempt from the audit requirement pursuant to s. Ins 50.02 (3), Wis. Adm. Code.

EDP Environment

Company personnel were interviewed with respect to the company's electronic data processing environment. Access to the computer is limited to people authorized to use the computer.

Company personnel back up the computers daily and once a week the data is moved to secure a off-site location.

A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

Business Continuity Plan

A business continuity plan identifies steps to be performed by a company in the event of business interruptions including, but not limited to, the inability to access its computer, the loss of information on its computer, the loss of a key employee, or the destruction of its office building. The company has developed a business continuity plan. The company's plan appears to be adequate.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

(1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and

(2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

> Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is in compliance with these requirements

Investment Rule Compliance

The investment rule for town mutual insurers allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1.	Liabilities plus $300,000	$472,354
2.	Liabilities plus 33% of gross premiums written	259,077
3.	Liabilities plus 50% of net premiums written	230,439
4.	Amount required (greater of 1, 2, or 3)	472,354
5.	Amount of Type 1 investments as of 12/31/2004	1,928,690
6.	Excess or (deficiency)	1,456,336

The company has sufficient Type 1 investments.

ASSETS

Cash and Invested Cash **$653,042**

The above asset is comprised of the following types of cash items:

Cash deposited in banks-checking accounts	$ 26,445
Cash deposited in banks at interest	626,597
Total	$653,042

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained in a bank. Verification of the checking account balance was made by obtaining confirmation directly from the depository and reconciling the amounts shown thereon to company records.

Cash deposited in banks at interest represents the aggregate of eight deposits in seven depositories. Deposits were verified by direct correspondence with the respective depositories. Interest received during the year 2004 totaled $1,563 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 1.14% to 4.45%. Accrued interest on cash deposits totaled $1,300 at year-end.

Book Value of Bonds **$1,308,200**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2004. Bonds owned by the company are kept under a custodial agreement.

Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. It was noted that five bonds were reported on Schedule C Section 1 using incorrect CUSIP numbers. It is recommended that the company correctly report CUSIP numbers on all future financial statements.

Interest received during 2004 on bonds amounted to $34,969 and was traced to cash receipts records. Accrued interest of $14,903 at December 31, 2004, was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments **$1,401,086**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2004. Stocks owned by the company are kept under custodial agreement and in the safety deposit box.

Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Dividends received during 2004 on stocks and mutual funds amounted to $44,154 and were traced to cash receipts records.

Premiums, Agents' Balances in Course of Collection **$6,236**

This asset represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end. A review of detailed premium records verified the accuracy of this asset.

Investment Income Accrued **$16,203**

Interest due and accrued on the various assets of the company at December 31, 2004, consists of the following:

Cash at Interest	$ 1,300
Bonds	14,903
Total	$16,203

To verify these balances, a sample of due and accrued interest for individual securities was recalculated and the results were considered reasonable. The sample was also verified to the 2005 custodial statement and to company cash records.

Electronic Data Processing Equipment **$1,538**

The above balance consists of computer hardware and operating system software, net of depreciation as of December 31, 2004. A review of receipts and other documentation verified the balance. Non-operating system software was properly nonadmitted.

Reinsurance Contingent Commission Receivable **$2,292**

The above asset represents the amount of reinsurance commissions that the company expected to receive as of December 31, 2004, based on the profitability of the business ceded under its contract with reinsurer. A review of the terms of the reinsurance agreement and year-end commission statement received from the reinsurer verified the above asset.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$48,281**

This liability represents losses incurred on or prior to December 31, 2004, that remained unpaid as of that date. The examiners reviewed the reasonableness of this liability by totaling actual loss payments made subsequent to December 31, 2004, with incurred dates in 2004 and prior years. To the actual paid loss figure was added an estimated amount for 2004 and prior losses remaining unpaid at the time of the examination. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule.

	Company Estimate	Examiners' Development	Difference
Incurred but unpaid losses	$51,634	$73,058	$(24,424)
Less: Reinsurance recoverable on unpaid losses	3,353	23,849	(20,496)
Net Unpaid Losses	$48,281	$49,209	$ (928)

The above difference of $928 was not considered material for the purposes of this examination. The examiners' development of the incurred but not reported (IBNR) reserve showed that one nonproperty claim in the amount of $20,000 for a loss incurred in 2004 was reported to the company in 2005. Since the company reinsures 100% of its nonproperty business, the fact that the company did not estimate this liability did not affect the company's surplus. However, it was noted that the company did not report a liability for IBNR loss reserve for nonproperty business on the 2004 annual statement. Since the company is the primary insurer on the policies, it is suggested that the company establish and report a liability for incurred but not reported losses on all future financial statements.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. Although the claims appear to be properly investigated, in many instances there is no written documentation of the investigation included within the claim file. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is not maintained.
2. Claim files did not contain sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

The Secretary handles the bulk of the claims calls. She takes the claim information and sets the policy file aside to indicate a potential claim. The Secretary writes the information down, but not in the loss register. She then contacts one of the adjusters to look at the claim. The adjusters handle everything from this point on with only minimum information given to the Secretary. After the claim settlement is reached and proof of loss is signed, the Secretary issues a check order and forwards it to the Treasurer who writes a check.

Starting January 1, 2005, the company implemented a new computerized cash disbursement system in which all checks are printed on the computer upon receiving the necessary information from the adjusters. The claims are entered into the claim register only after one of the following has occurred: 1) the claim is settled; 2) the claim is paid; 3) at year-end. The following information is entered into the claim register: claim number, insured name, policy number, brief description of the loss, amount of policy coverage, and the amount paid for the claim. Only after the claim is entered in the loss register is a claim number assigned.

The examiners found an instance when a claim reported in 2004 for a loss incurred in 2001 was not entered in the claim register because the company did not expect any payments to be made to the claimant. In all cases the claim register lacks substantial information necessary to comply with s. Ins 13.05 (3) (f) and (4) (e), Wis. Adm. Code. The records do not include the date the losses were reported to the company, the estimated amount of the losses, and a notation whether the claim is closed, and whether the claims were closed without payment.

Effective May 20, 2005, the company switched its claim register over to a computerized accounting system. Among information required to be entered into the system in order to complete a claim entry are claim number, the date when the claim was reported, policy number, estimated amount of loss, status of the claim, and description of the claim. It appears that the requirements of s. Ins 13.05 (3) (f), Wis. Adm. Code, will be met by switching over to the new system. However, the completeness of the new claim register depends on a timely recording of each new claim. It is again recommended that the company comply with s. Ins 13.05 (4) (e), Wis. Adm. Code. Specifically, the company should enter all claims into the claim register when the claim is reported.

The company does not maintain claim files. The Secretary retains the signed proof of losses. The Treasurer maintains copies of proofs of loss and all documentation related to the adjusting of the claims. For smaller claims there is no documentation retained. For the majority of the larger claims, the invoices for the repairs are kept. There is no specified dollar amount above which the invoices should be obtained and kept, and in the course of the claim testing it was evident that for some claims over $1,000 there was no documentation retained by the company. The company maintains detailed records of all documentation related to disputed claims. However, in order to avoid any future obligations which might emerge due to lack of proper documentation, the company should maintain all documents related to all claims. It is again recommended that the company document all communications with insureds and claimants in order to avoid the unfair claims settlement practice described in s. Ins 6.11 (3) (a) 1, Wis. Adm. Code.

Unpaid Loss Adjustment Expenses $405

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2004, but which remained unpaid as of year-end. It appears that the methodology used by the company and its CPA in establishing this liability is to estimate the expense based upon the number of open claims at year-end. The adjusters submit a list of policyholders for which claims were settled. The Secretary verifies that there were no duplicate payments and also that all claims that have been settled were paid at year-end. Also, the company keeps track of adjusting expenses incurred. The company’s current methodology for establishing this liability was found to inadequately estimate the company’s loss adjusting expenses.

The examiners used a “paid loss adjustment expense to paid loss” methodology to determine the expense incurred by the company related to the settlement of losses for the past three years. The examiners weighted the more recent year’s data to reflect current trends. Using that methodology, the estimated unpaid loss adjustment expenses were $4,531. The difference of $4,126 was deemed to be below tolerable error and no audit adjustment was made. It is again recommended that the company establish a method of determining unpaid loss adjustment expenses, such as paid-to-paid methodology, in order to determine a more adequate loss adjustment expense reserve.

Commissions Payable **$2,139**

This liability represents the commissions payable to agents as of December 31, 2004. The examiners reviewed the company's commission calculation and found the liability to be reasonably stated. The amount was verified by tracing to the cash disbursement records.

Fire Department Dues Payable **$77**

This liability represents the fire department dues payable to the State of Wisconsin as of December 31, 2004. The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

Unearned Premiums **$92,947**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology. Policy data was tested and recalculated to verify the accuracy of this liability.

Reinsurance Payable **$10,562**

This liability consists of amounts due to the company's reinsurer at December 31, 2004, relating to transactions which occurred on or prior to that date. Subsequent reinsurance accounting verified the amount of this liability.

Amounts Withheld for the Account of Others **$256**

This liability represents employee payroll deductions in the possession of the company at December 31, 2004. Supporting records and subsequent cash disbursements verified this item.

Payroll Taxes Payable **$431**

This liability represents the company's portion of payroll taxes incurred prior to December 31, 2004, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

Accounts Payable **$3,773**

This liability represented an accrual for general expenses incurred prior to December 31, 2004, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

Premiums Received in Advance **$13,483**

This liability represents the total premiums received prior to year-end for policies with effective dates after December 31, 2004. The examiners reviewed 2004 premium and cash receipt records to verify the accuracy of this liability.

V. CONCLUSION

The company reported admitted assets of $3,388,597 and policyholders' surplus of $3,216,243. The company has increased its surplus 18% since the prior examination. Although 2004 was a good year with a relatively low amount of losses, the company had a high composite ratio (2004 composite ratio was 178%; average composite ratio for 6 years was 167%). Investment income covered negative operating results in 5 out of the 6 years since the last exam. In 2004. the company had its first net loss in over 25 years. Net investment income decreased in 2003 and 2004 reflecting the performance of the financial markets.

The company complied with 17 of the 20 prior recommendations. Three recommendations of the previous report were partially complied with and are repeated in this report. An additional 5 recommendations and 2 suggestions were made as a result of the current examination.

The company has acquired a new computer and accounting software. It is the company's intention to bring its operations and accounting system into compliance with OCI requirements.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 16 - Corporate Records—It is recommended that the company adhere to its articles of incorporation as they relate to the minimum number of members, or quorum, required to be present at the annual meeting before it can validly proceed to transact business.

2. Page 17 - Fidelity Bond and Other Insurance—It is recommended that the company obtain proper fidelity bond coverage for all officers, directors, and employees having direct access to the company's assets in accordance with s. Ins 13.05 (6), Wis. Adm. Code.

3. Page 17 - Underwriting—It is recommended that the company define and document the underwriting guidelines it follows in its business practice in order to avoid unfair discrimination among policyholders described in s. 628.34 (3) (a), Wis. Stat.

4. Page 18 - Underwriting—It is suggested that the company finalize its criteria for requiring photographs of insured property.

5. Page 18 - Underwriting—It is recommended that the company properly complete general interrogatories on all future annual statements by reporting the amount of the largest risk and the company's net retention in regard to this risk in accordance with the Town Mutual Annual Statement Instructions.

6. Page 21 - Book Value of Bonds—It is recommended that the company correctly report CUSIP numbers on all future financial statements.

7. Page 24 - Net Unpaid Losses—It is suggested that the company establish and report a liability for incurred but not reported losses on all future financial statements.

8. Page 25 - Net Unpaid Losses—It is again recommended that the company comply with s. Ins 13.05 (4) (e), Wis. Adm. Code. Specifically, the company should enter all claims into the claim register when the claim is reported.

9. Page 26 - Net Unpaid Losses—It is again recommended that the company document all communications with insureds and claimants in order to avoid the unfair claims settlement practice described in s. Ins 6.11 (3) (a) 1, Wis. Adm. Code.

10. Page 27 - Unpaid Loss Adjustment Expenses—It is again recommended that the company establish a method of determining unpaid loss adjustment expenses, such as paid-to-paid methodology, in order to determine a more adequate loss adjustment expense reserve.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Kerri Miller of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination.

Respectfully submitted,

Elena Vetrina
Examiner-in-Charge